United States
Circuit Court of Appeals

For the Ninth Circuit

THE WESTERN PACIFIC RAILROAD CORPORATION, a corporation, *Appellant,* vs. THE RAILROAD CREDIT CORPORATION, a corporation, *Appellee.*	No. 10,962
THE WESTERN PACIFIC RAILROAD CORPORATION, *Appellant,* vs. THE RAILROAD CREDIT CORPORATION, *Appellee.*	No. 10,966

(Consolidated Cases)

Reply Brief of The Railroad Credit Corporation As Appellee on the Appeals of The Western Pacific Railroad Corporation

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Subject Index

Table of Authorities Cited

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I.

SUMMARY STATEMENT OF PROCEEDINGS, APPEALS, AND MANNER OF PREPARING RECORD

There Are Three Appeals.

In the Matter of The Western Pacific Railroad *Company,* Debtor, United States District Court, Northern

District of California, Southern Division, No. 26,591-S, a railroad reorganization proceeding under §77 of the Bankruptcy Act, the District Court on September 14, 1944, made its order construing a plan of reorganization which theretofore had been approved. (II-R 143; Opening Brief of The Railroad Credit Corporation on its Appeal in No. 10,962.) The Railroad Credit Corporation appealed from portions of that order. The Western Pacific Railroad *Corporation* appealed from other portions of the same order. These two appeals were taken on a single record, No. 10,962 in this Court.[1]

The proceedings leading to the order appealed from in No. 10,962 were initiated by a petition filed in the reorganization proceedings on May 9, 1944, by the Reorganization Committee designated in the Plan of Reorganization to carry out the plan, and asking for a construction of parts of the Plan. One of the issues presented was the effect of the Plan on accommodation collateral pledged with The Railroad Credit Corporation by The Western Pacific Railroad *Corporation*. (II-R 69-94) On May 22, 1944, 13 days after the filing of that petition, The Western Pacific Railroad Corporation, as plaintiff, commenced a plenary action in the same court against The Railroad Credit Corporation, as defendant (Civil Action No. 23,-307-S). The complaint attempted to tender the same issue tendered by the Reorganization Committee's petition (III-R 2-10). In both proceedings the District Court ruled

1. The Western Pacific Railroad Corporation is not concerned with or affected by the matters raised on the appeal of The Railroad Credit Corporation. But considerations involved on the appeal of The Railroad Credit Corporation touch matters raised on the appeals of The Western Pacific Railroad Corporation. For that reason the Opening Brief of The Railroad Credit Corporation was served upon The Western Pacific Railroad Corporation, and we shall take the liberty of referring to some of the matters it sets out at length.

against The Western Pacific Railroad Corporation. In the Reorganization proceeding the Court did this by its order of September 14, 1944. The Western Pacific Railroad Corporation appealed in No. 10,962. In the plenary action the court's ruling was carried into a judgment (III-R 16). The Western Pacific Railroad Corporation appealed from this judgment in No. 10,966 in this Court.

The Records on Appeal.

At an earlier stage in the reorganization proceedings there were appeals to this Court from the order of the District Court approving the Plan of Reorganization. That was No. 9714 in this Court. Some of the matter contained in the record in No. 9714 is pertinent on these appeals. It was incorporated by reference in the printed record in No. 10,962. This is explained in the Opening Brief of The Railroad Credit Corporation on its appeal in No. 10,962, pp. 1-3. As in that Brief we shall refer to matter physically contained in the printed record in No. 9714 as "I-R", and to matter physically contained in the printed record in No. 10,962 as "II-R". The Western Pacific Railroad Corporation, on its appeal from the judgment in the independent plenary action, prepared a separate record. This is the printed record in No. 10,966. We shall refer to this as "III-R". III-R incorporates by reference the record in No. 10,962, and by consequence the record in 9714. It is important to make this clear because of some statements in The Western Pacific Railroad Corporation's brief.

Where it is necessary to differentiate the proceedings in the District Court we shall do so by number, using the

numbers assigned to the records in *this* Court, designating the reorganization matter as No. 10,962, and The Western Pacific Railroad Corporation's independent plenary action as No. 10,966.

All emphasis by use of bold-face type is ours.

Summary Statement of the Proceedings in the District Court.

To avoid confusion of The Western Pacific Railroad *Company,* the railroad corporation in reorganization as a debtor under Bankruptcy Act §77, with The Western Pacific Railroad *Corporation* we shall hereafter refer to The Western Pacific Railroad *Company* as the Debtor.

The Debtor had borrowed $2,596,439.00[2] from The Railroad Credit Corporation, for which it gave partial security and for which others gave additional security. Part of the security given by others was the assignment to The Railroad Credit Corporation by The Western Pacific Railroad Corporation of two claims for money advanced by the latter to subsidiaries of the Debtor—Standard Realty & Development Company[3] and Sacramento Northern Rail-

2. The Railroad Credit Corporation's claim was this amount reduced by $150,829.12 received under the Marshaling and Distributing Plan, 1931, so that the principal of the claim in the reorganization proceeding was $2,445,-609.88. See Opening Brief of The Railroad Credit Corporation on its appeal, pp. 7, 14, 16. In Paragraph 4 of subdivision P of the Plan of Reorganization the principal amount of this claim is stated as $2,455,610.00. This is an error, $10,000.00 too much. At every other place in the record the correct amount is given. The correct amount can be determined by taking the principal of the Debtor's notes to The Railroad Credit Corporation and deducting the credit of $150,892.12 (Opening Brief of The Railroad Credit Corporation on its appeal, pp. 14, 16). The figure used in the opinion of the Supreme Court is the correct figure.

3. The amount originally due from Standard Realty & Development Company to The Western Pacific Railroad Corporation and assigned to The Railroad Credit Corporation as accommodation security for the Debtor's notes was $120,000.00. (See Opening Brief of The Railroad Credit Corporation on its appeal, p. 7, note 9; Stipulation of Facts Not in Dispute, I-R 1025; Debtor's Note of March 25, 1933, II-R 53.) This amount was reduced by a payment of $10,000.00. (See evidence on the hearing of June 2, 1944, II-R 115-120, 122 et seq.)

way[4] (Opening Brief of The Railroad Credit Corporation on its appeal in No. 10,962, pp. 11-16, 54, 55). This is the accommodation collateral referred to on these appeals.

In the Debtor's reorganization proceeding The Railroad Credit Corporation appeared as a secured debtor and The Western Pacific Railroad Corporation appeared as an unsecured creditor.[5] Under the Debtor's Plan of Reorganization certain of its properties, upon which The Railroad Credit Corporation's security in the form of the Debtor's General and Refunding Mortgage Bonds was a lien, were allotted to The Railroad Credit Corporation by allocating new securities of the reorganized company (Opening Brief of The Railroad Credit Corporation in No. 10,962, pp. 9-11, 18-29). The Western Pacific Railroad Corporation now claims that by this allocation the accommodation collateral it provided was exonerated.

After the Debtor's Plan of Reorganization was approved, and the approval had become final, questions of the meaning and effect of the Plan arose. To resolve these the Reorganization Committee provided for in the Plan filed a petition in the District Court in the reorganization proceeding, submitting these questions to the Court (II-R 69-94). One matter so submitted was The Western Pacific Railroad Corporation's claim of exoneration of the ac-

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4. The amount of this advance to Sacramento Northern Railway and assigned to The Railroad Credit Corporation as accommodation collateral for the Debtor's note was $856,260.00 (Stipulation of Facts Not in Dispite, I-R 1025; Debtor's Note of March 25, 1933, II-R 53; Testimony of DeGrath, II-R 120).

5. Bankruptcy Act, §77(f), provides: "Upon confirmation by the judge, the provisions of the plan and of the order of confirmation shall, subject to the right of judicial review, be binding upon the debtor, all stockholders * * * and all creditors secured or unsecured, whether or not adversely affected by the plan, and whether or not their claims shall have been filed, and, if filed, whether or not approved, including creditors who have not, as well as those who have, accepted it."

commodation collateral held by The Railroad Credit Corporation (Petition, Part III, Paragraphs 9-17; II-R 76-84). On May 9, 1944, the day the petition was filed, the District Court set the petition for hearing on June 2, 1944, and directed that notice be given accordingly (II-R 95-97).

On May 22, 1944, The Western Pacific Railroad Corporation began its independent plenary action (No. 10,966), attempting to raise the same question (III-R 2-10; see p. 2 above). On the next day the parties to that action stipulated that the matter be heard at the time and place fixed for hearing the Reorganization Committee's petition (III-R 11). On May 31, 1944, The Railroad Credit Corporation, defendant in the independent plenary action, filed its motion for dismissal because "the complaint fails to state a justiciable claim against defendant upon which relief can be granted, or in the alternative to grant summary judgment for defendant" (III-R 10-11).

Both matters[6] came on for hearing at the time noticed and agreed, and were heard together. Testimony was taken (II-R 109-143). Without objection the Court took judicial notice of its own records (II-R 141). If there were any possible question of the right of the Court to consider the record in No. 9714 (I-R)—there is no room for doubt—the doubt was removed. It was further agreed that **all matters before the Court might be considered by it in ruling on the motion to dismiss the independent plenary action** (II-R 135, 142, 143).

On June 19, 1944, in the independent plenary action, the Court granted defendant's motion to dismiss (III-R 12, 13).

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6. The petition of the Reorganization Committee for construction of the Plan, and the motion of The Railroad Credit Corporation to dismiss the independent plenary action.

On June 21, 1944, the Court filed its corrected memorandum opinion and order in the reorganization proceeding, construing the Plan of Reorganization, ruling that the accommodation collateral furnished by The Western Pacific Railroad Corporation to The Railroad Credit Corporation was not exonerated by the allocation of securities to The Railroad Credit Corporation under the Plan of Reorganization, and directing counsel to submit a form of decree (II-R 98-108). The Railroad Credit Corporation, as defendant in the independent plenary action, then noticed its motion in that action to enter judgment in its favor, attaching to its notice of motion a proposed form of judgment. At the time and place noticed the Court made and filed its judgment in the form proposed (III-R 13-17). This judgment recites that The Railroad Credit Corporation's motion to dismiss

> "was heard upon the complaint, defendant's motion, **stipulations of the parties, and evidence introduced**",

was argued and submitted, and the Court being advised it is

> "ORDERED, ADJUDGED AND DECREED that plaintiff take nothing by its complaint herein, and that this action be, and the same is hereby, dismissed, and that defendant have and recover of and from plaintiff its costs of suit herein, taxed in the sum of $20.85."

On September 16, 1944, The Western Pacific Railroad Corporation appealed from this judgment (III-R 117). This is the appeal in No. 10966. Meanwhile, on September 14, 1944, in the reorganization proceeding, the Court filed its formal decree disposing of the petition of the Reorganiza-

tion Committee (II-R 143-148). On October 13, 1944, The Western Pacific Railroad Corporation filed its notice of appeal from so much of that decree as determined that the accommodation collateral provided by it was not exonerated by the Plan of Reorganization (II-R 150, 151). The Railroad Credit Corporation appealed from other portions of the same decree. These are the appeals in No. 10,962.

It is apparent that the matters and showing before the District Court on the motion to dismiss the independent plenary action (No. 10,966) were exactly those before the Court on the petition for construction of the Plan, with the exception only of the complaint in the independent action and the motion to dismiss. The appellants from portions of the decree of September 14, 1944, in the reorganization preceeding (No. 10,962), were collaborating to get up a single record. It would contain the matters which were before the Court. There was no reason to duplicate them in No. 10,966. The parties stipulated, to avoid duplication, to incorporate by reference in No. 10,966 the record in No. 10,962. That this could be done was apparent from the designation of record on appeal filed by The Western Pacific Railroad Corporation in No. 10,966 (III-R 22-26). The major portion of the record desired was designated by reference to the designations filed in the reorganization matter, No. 10,962 (III-R 23, par. 3), and then the designation, Paragraph 13 (III-R 24-26), provides:

> "The issues involved on the appeal of The Western Pacific Railroad Corporation in the above entitled matter" (the independent plenary action No. 10,966) "**are substantially the same as the issues involved in the appeal in" the reorganization proceeding (No. 10,-962)** "by The Western Pacific Railroad Corporation

from the order construing Plan of Reorganization, made by this Court and filed on September 14, 1944, and are part of the issues raised by the appeal of The Railroad Credit Corporation from the same Order, filed October 13, 1944. For the purpose of shortening the record" appellants "have agreed to file, and will file, a stipulation that the Circuit Court of Appeals for the Ninth Circuit may make an order consolidating the appeal" with the appeal in No. 10,962 "for briefing, for oral argument **and the purposes of the record** * * * and providing that **each and every item or part of the record on appeal" in No. 10,962 "shall be deemed a part of the Transcript of Record on" the appeal in No. 10,966.** "When said stipulation * * * is filed herein and when said Order of the Circuit Court of Appeals * * * is filed in the above entitled action, then such stipulation and order are hereby designated for inclusion in the transcript of record hereby designated in lieu of the matters described and designated in Item 3 in this designation."

The parties made the stipulation contemplated by the designation. This Court made its order on that stipulation approving it and ordering accordingly (III-R 32-36). The stipulation recites the pendency of the reorganization proceeding, and that The Railroad Credit Corporation and The Western Pacific Railroad Corporation "appeared as creditors of the Debtor" in that proceeding (III-R 33). It then states a hearing was had on June 2, 1944, the making of the decree of September 14, 1944, and the taking of the appeals. It then recites the pendency of the independent plenary action, and provides:

"**By stipulation** of plaintiff and defendant the **hearing of said action, and of a motion by defendant for**

> **dismissal thereof,** was heard by the District Court on June 2, 1944, and **in the same proceeding and upon the same showing, evidence and record,** except as to pleadings, as the hearing of the aforesaid petition of the Reorganization Committee in action #26,591-S." (This last reference is to No. 10,962.) (III-R 33)

It is then provided that the three appeals "be consolidated for briefing and for oral argument, **and may be heard upon the same record**"; that, since the independent plenary action (No. 10,966) "**was determined upon the same evidence and record,** except as to pleadings, and in the same hearing, **as the reorganization matter**" No. 10,962, "there need not be repeated and included in the Transcript of Record on appeal by The Western Pacific Railroad Corporation in said plenary action" No. 10,966 "any item or part of the record on appeal which may be included in the records on appeal in" No. 10,962; that any matter appearing in the record in No. 10,962 may be used by either of the parties in No. 10,966, i. e., "as matter included in the Transcript on Appeal in respect to either of the appeals hereby consolidated". The stipulation closes by providing that it shall be included in the record on appeal in No. 10,966 (III-R 32-36).

This matter has been stated at length because The Western Pacific Railroad Corporation seems to have forgotten it, and makes statements based solely upon allegations of its complaint in the independent action which are contradicted by the evidence and matters of record before the Court when it dismissed the complaint.

II.

MATTERS URGED BY THE WESTERN PACIFIC RAILROAD CORPORATION ON ITS APPEALS

The appellant, The Western Pacific Railroad Corporation, seems to urge three points:

1. On the merits, the accommodation collateral furnished by it to The Railroad Credit Corporation was exonerated by the Plan; the Plan makes The Railroad Credit Corporation whole and satisfies and discharges its claim. The Railroad Credit Corporation is **not** made whole **in fact.** But this is immaterial because in **legal** contemplation it is made whole by the Plan, whatever the dollars and cents result to The Railroad Credit Corporation.

2. The Western Pacific Railroad Corporation was not a party to the Plan, and the property here involved—the accommodation collateral furnished by it—never having been the property of the Debtor, the District Court had no jurisdiction to construe the Plan and determine that the Plan did not, in legal contemplation, make The Railroad Credit Corporation whole. By consequence, whether the accommodation collateral was exonerated could be determined only in the independent action (No. 10,966).

3. In any event the District Court acted only as an arbitrator. In effect, by agreeing to the Plan, the parties to the Plan agreed that the District Court might so act, and this agreement carried with it the agreement they would not appeal from any determination by the District Court. (The effect of this is to say that this Court does not have jurisdiction of the appeal from the order made in the reorganization proceeding. How this helps appel-

lant The Western Pacific Railroad Corporation is not apparent. The Railroad Credit Corporation is not appealing from the parts of the order involved on the appeals of The Western Pacific Railroad Corporation. The latter is appealing. The Western Pacific Railroad Corporation is in no way interested in the phase of the order from which The Railroad Credit Corporation is appealing. We do not concede, however, that the District Court was acting as claimed. This is discussed below.)

In spite of points 2 and 3 above, **appellant states that it desires a determination on the merits** (see its Brief, pp. 9, 39). In this, at least, it is consistent with the way in which the matter was heard and disposed of in the Court below, with its consent and by stipulation, whether the merits be deemed to have been properly disposed of in the reorganization proceedings or in the independent action. (See pp. 6 to 10 above.)

III.

THE RAILROAD CREDIT CORPORATION WAS NOT MADE WHOLE, IN FACT OR IN LAW, AND THE ACCOMMODATION COLLATERAL HAS NOT BEEN EXONERATED.

Detailed Statement of the Position of The Western Pacific Railroad Corporation as Exposed in Its Brief.

The precise position taken by The Western Pacific Railroad Corporation is important not only in considering the merits of its claim, but as well in considering its claim that the District Court had no jurisdiction to dispose of the matter in the reorganization proceeding, and erred in dismissing the independent action.

There is no claim that The Railroad Credit Corporation has been made whole in fact. There is no claim that The Railroad Credit Corporation has **in fact** received in money, property, or securities, an equivalent in value of its claim against the Debtor. There is no evidence to support any such claim if it were made. (Compare *Union Trust Co. v. Willsea,* quoted in note 43, p. 40 below.) The Western Pacific Railroad Corporation says:

> "We agree that there is no presumption that The Railroad Credit Corporation has been made whole, and we rely on no such presumption." (Brief, p. 43)

To the contrary, The Western Pacific Railroad Corporation relies upon what it characterizes, in urging that the holders of First Mortgage Bonds were made whole, as a fiction (Brief, p. 37). Appellant's **only** position is that, while The Railroad Credit Corporation has not been made whole in fact, the Plan makes it whole in legal contemplation, not only as to the Debtor, but as to third persons who furnished accommodation collateral.[7] If doubt could

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7. This is the way appellant's Brief phases its position: The question is "whether by reason of **the provisions in the Plan of Reorganization** * * * this appellant is not now entitled to have returned to it as exonerated the accommodation collateral furnished by appellant." (P. 9) The securities to be issued "were to be taken at the values fixed **by and in the Plan**", and "were to be issued in full satisfaction of its [RCC] claim, and that thereby the accommodation collateral furnished and pledged by this appellant was exonerated and should be returned to appellant". (P. 10) There is then an attempt to buttress the proposition, not by argument but by dogmatic assertion, as point II, pp. 18-28. One of the consequences of making The Railroad Credit Corporation whole was that the excess collateral was released and this was recognized by the Interstate Commerce Commission. (P. 33) "The Railroad Credit Corporation was made whole by an **allotment** of certain securities, including common stock which had no face value at all. But the Interstate Commerce Commission determined, and the District Court affirmed the determination, that The Railroad Credit Corporation, possessing no senior right, would be made whole by an **allotment** of the same stock at $62.00 per share and without resorting to all of the collateral pledged by the principal Debtor." (P. 43) "Our reliance is upon the facts of record as hereinbefore recited, which conclusively prove that The Railroad Credit Corporation has been made whole **as a matter of law.**" (Pp. 43, 44)

remain after the statements in its Brief, the complaint in the independent action demonstrates that it is indissolvably wedded to the theory that The Railroad Credit Corporation was made whole only in law as a result of construction of the Plan. This is discussed below at pp. 51, 52.

There are considerations of fact and of law which fully answer appellant's assertions. It seems more orderly to state all of the factual considerations at one place than to take them piecemeal as they apply to each proposition.

The Facts.

The source from which the facts are to be taken is the first important consideration. While the complaint in the independent action is made up almost wholly of conclusions of law,[8] there are some statements in it which, taken alone, might be tortured into statements of ultimate fact. Appellant has endeavored to make use of some of these without discrimination—without differentiating discussion of its appeal from the order in the reorganization proceeding (No. 10,962) from discussion of its appeal from the judgment in the independent action (No. 10,966)[9]—as

8. Attempts to state the effect of the Plan and the action of the Commission and the courts. These are necessarily only legal conclusions in this complaint because the complaint, by reference, incorporates the action of the Commission and courts. See below.

9. These are allegations of the complaint, **contradicted by the record which was before the Court**, of which appellant endeavors to make use: The First Mortgage Bonds were secured by "a first and paramount lien on all of the properties" of the Debtor except, as found in the modified report of the Interstate Commerce Commission, properties of a value of $1,879,965.00. (III-R 5). The allotment of securities, under the Plan, to the First Mortgage bondholders made them whole (in the Brief appellant argues at some points that they were made whole and then at other places contradicts this by the statement that they were not made whole) without exhausting the security under the first mortgage bonds and for giving up their preferred position and taking stock the First Mortgage Bondholders were compensated by having common stock given to them at a differential of $5.00 below the figure at which it was given to The Railroad Credit Corporation. (III-R 7) Again, "this allotment of new securities made said defendant (The Railroad Credit Corporation whole". (III-R 7)

though they were conclusive of the facts. However proper this might be where a complaint was attacked by motion to dismiss, and there was nothing before the Court but the complaint and the motion, it is not proper on these appeals. First: The allegations of the complaint in the independent action were not before the Court, and had no bearing upon its determination in making its order in the reorganization proceeding. That order was made in view of the whole record, including the testimony taken at the hearing on June 2, 1944. Second: The complaint in the independent action (Paragraph IV, III-R 3, 4) made reference to and incorporated the reports of the Interstate Commerce Commission and the decisions of the District Court, this Court and the Supreme Court of the United States. In such circumstances allegations which attempt to state what the Plan did are mere conclusions and must be disregarded where unsupported by, or in conflict with, the Plan. Third: By stipulation, all matters before the Court in the reorganization proceeding were before the Court in passing on the motion to dismiss. (See p. 6 above.) The Court was not restricted to the complaint. It had the full story before it. Last: If appellant is sincere in its protestation that it wants a decision on the merits, there can be no excuse for relying on a pleading which is contradicted by the record. This Court should disregard the shadow and look to the substance. The substance appears in the records in No. 9714 (I-R) and No. 10,962 (II-R).

We turn, then, to the real facts.

The position of The Railroad Credit Corporation, the character and amount of its claim and the security held

by it, including accommodation security furnished by The Western Pacific Railroad Corporation, has been sufficiently stated. (See pp. 4, 5 above and Opening Brief of The Railroad Credit Corporation on its appeal, pp. 7 (including note 9), 11-18, 54, 55.)

It is not necessary again to recite the detail of how the Interstate Commerce Commission determined what new securities should be issued. This is fully covered in the reports of the Commission and the opinion of the Supreme Court of the United States (318 U.S. 448, 87 L.ed. 892; and see the Opening Brief of The Railroad Credit Corporation on its appeal, pp. 18-25).

The Commission first determined what new securities should be issued, without regard to who had claims, the nature of those claims, or the security held. It determined what the Debtor reasonably could be expected to earn, and, upon this basis, what new securities could be supported. It concluded that those earnings would justify only a given amount of fixed charges. Having determined what charges had a primary claim on anticipated income, it next allotted the remaining amount of justifiable fixed charges to interest-bearing bonds, capitalized this, and thus arrived at the amount of bonds to be issued. The prospects of income were such that additional securities could be issued. Accordingly, provision was made for income bonds. The Commission determined what anticipated income properly could be allotted for these and fixed the principal amount by capitalizing on a 4½% basis. Then, using the same method, it determined the proper amount of preferred stock, and, lastly, fixed on an amount of no-par common stock (i. e., number of shares) which, in its

opinion, the reasonably to be anticipated income would justify, after taking care of the senior securities.

Only after this had been done, the Commission addressed itself to allocation of these securities among the creditors. Only then was the character of the creditors' claims, and the security held by each, of significance.

Again, because of suggestions attempted, there should be no misunderstanding about how this allocation was made. Some of the material was set out in the Opening Brief of The Railroad Credit Corporation on its appeal, pp. 18-29. We hope to avoid repetition, but some amplification is necessary. The material for this is in the reports and orders of the Commission and in the opinion of the Supreme Court (318 U.S. 448, 87 L.ed. 892). The two matters to be noticed are (1) the determination of the relation between, and respective priorities of, holders of first mortgage bonds and holders of general and refunding mortgage bonds, and (2) determinations made that The Railroad Credit Corporation was not required to surrender its accommodation collateral.

The **original** report and order of the Commission of October 10, 1938 (I-R, 194 et seq.) dealt with both matters. In dealing with the respective priorities of the first mortgage and the general and refunding mortgage (I-R, 261-267), the Commission followed almost word for word the proposed report of its Bureau of Finance (see I-R, 175-189). This is the substance of the report: All three plans submitted to the Commission were "predicated on the priority of the existing first mortgage over the general mortgage." "The trustee under the first mortgage and the holders of bonds issued under that mortgage contend that

the first mortgage is a first lien on substantially all the debtor's property, except equipment subject to existing leases, conditional-sales agreements, or equipment-trust agreements. The general mortgage trustee and those creditors with whom general-mortgage bonds are pledged contend, however, that the first mortgage is not a lien, or is a lien only to the extent of the proceeds of first-mortgage bonds extended thereon, on cash and collateral held by the trustees under the general mortgage, on" specified property. These latter parties contended that the last mentioned property is "not only free from the lien of the first mortgage, but is subject to the lien of the general mortgage and that its value is sufficient for the full payment of all debts secured under the general mortgage" (I-R, 261, 262). These contentions were then discussed. The Commission concluded:

> "While due recognition must be accorded to the rights of the creditors with whom are pledged the general-mortgage bonds, those creditors are not entitled to the same treatment as the first-mortgage bondholders, who should be considered as having a first lien upon practically all of the assets of the Debtor. It follows that holders of the Debtor's first-mortgage bonds should receive securities of a higher rank than those allotted to other creditors, at least to the extent that existing conditions will permit." (I-R, 267)

The holders of general-mortgage bonds were clearly entitled to priority over the unsecured claims (I-R, 267). The amounts of the various claims were discussed, demands on the Debtor's income were noticed, and from this it was said that

> "it is clear that even though all securities remaining available for distribution after satisfying claims of the first-mortgage bonholders **are allotted to the other secured creditors, such securities will be inadequate to satisfy their claim.** For this reason, and for the reason stated with respect to the finding that the equity of the existing stock has no value, we find that the claims of the unsecured creditors * * * have no value * * *." (I-R 269)

Again, after noticing the claims of the holders of general-mortgage bonds, and after having stated that they should receive only no-par stock, the Commission said:

> "Having found that the 159,462 shares of common stock available for distribution **are inadequate in value to satisfy the aggregate claims of these parties,** it follows that it would be inequitable to distribute such stock in proportion that each claim bears to the total amount of such stock. The value of each of the claims is proportionate to the collateral securing it, and we find that the **allocation of the stock should be made on the basis of the collateral held rather than on the amount of the claims."** (I-R 271)

The first of these last two quoted excerpts is quoted by the Supreme Court in its opinion (318 U.S. at 462, 87 L.ed. at 926).

In line with these findings, the Commission stated the proper allocation of new securities:

> "Proceeding to the allocation of the available securities, the plan should provide that **all** of the new income bonds, $19,716,040, principal amount, **all** of the new preferred stock, $29,574,060 par value, and 154,241 shares of the new no-par-value common stock

> should be allotted to the holders of existing **first-mortgage bonds**. The remaining 159,462 shares of no-par-value common stock should be allotted to the secured note holders on the basis indicated below." (I-R 270)

The short of this is that the Commission concluded that the lien of the general-mortgage bonds was junior to the lien of the first-mortgage bonds and, accordingly, all the two classes of senior securities (bonds and preferred stock) were allotted to the holders of first-mortgage bonds and only the junior common stock was allotted, in part, to holders of general-mortgage bonds. The Commission's original plan followed this allocation (J, I-R, 293).

The **original** report, order and plan also dealt with The Railroad Credit Corporation's accommodation collateral. The Commission notices that The Railroad Credit Corporation held such collateral—an assignment of certain advances by The Western Pacific Railroad Corporation (I-R 226); that in the briefs in support of exceptions to the proposed report of the Bureau of Finance, the bondholders' committee had proposed that the plan

> "shall not prejudice the rights of The Reconstruction Finance Corporation or The Railroad Credit Corporation against collateral which has been delivered by third persons to secure the obligations of the Debtor and which does not itself constitute a claim against the Debtor or the Debtor-property." (I-R 235)

The Commission's conclusion was:

> "The Plan should provide, however, that its approval and confirmation in no wise disturbs or alters the rights of The Reconstruction Finance Corporation

and The Railroad Credit Corporation in collateral pledged with them by parties other than the Debtor." (I-R 271)

In the original plan, it was provided in subdivision O:

"The approval and confirmation of the plan shall in no wise disturb or alter the right or interest of the Reconstruction Finance Corporation and The Railroad Credit Corporation in collateral pledged with them by parties other than the Debtor." (I-R 298)

The **supplemental** report of the Commission on further consideration was promulgated June 21, 1939 (I-R 300 et seq.). It, too, dealt with the subjects we have just noticed. Objections had been made to the first report and order and these were considered. The supplemental report is not a full report. It simply passed on the objections and modified the earlier report where necessary. The first report was not vacated. It was only modified and supplemented. This is clear from the tenor of the supplemental report as a whole. The report so states (I-R 354, 362). That the original report was not to be disregarded, but, to the contrary, was to be given proper consideration, is made clear by the opinion of the Supreme Court. (See, for example, 318 U.S at 454, 87 L.ed. 921, note 2; 318 U.S. at 462, 78 L.ed. at 926; 318 U.S. at 488, 87 L.ed. at 940.)

One objection to the Commission's original report went to its conclusion of absolute and over-all priority of the first-mortgage bonds. This was reconsidered in the supplemental report (I-R 312, et seq.). The Commission said:

"Upon further consideration, we also are of the opinion that the value of the assets pledged under

> the general and refunding mortgage upon which that mortgage admittedly constitutes a first lien requires a re-examination of the allocation of new securities * * *. These assets consist of cash in the hands of the mortgage trustee amounting to $223,732",

and a note and stock of Tidewater Southern Railway Company, and other assets. **The conclusion was that the note and stock of the Tidewater Southern had substantial value** (I-R 312-315). The ultimate conclusion was:

> "From the foregoing, it appears that the creditors secured by the general and refunding mortgage bonds should be awarded new income mortgage bonds in the amount of $732,010, and new participating preferred stock of a par value of $1,147,955. Applying to these amounts the proportioned amounts of general and refunding mortgage bonds securing the notes of the Finance Corporation, The Credit Corporation, and The James Company",

the Commission made the ultimate allocation which appears in the final plan of reorganization, subdivision P (Opening Brief of The Railroad Credit Corporation on its appeal, p. 26, et seq.). The report itself recognized that the modification of the earlier report required this new allocation.

> "The above modifications require further modification of our prior report and order with respect to the allocation of the reorganization securities." (I-R 316)

The opinion of the Supreme Court recognized the ultimate conclusion; recognized that "the later general and refunding mortgage bonds, $18,999,500 in face amount, are secured by a **first lien** on properties determined by the

Commission to be of a value and earning power sufficient to support" the issues of new income bonds and preferred stock allocated to the holders of the general and refunding mortgage bonds and, speaking of these bonds, went on:

> "They are further secured, subject to the prior rights and other exceptions of the obligations listed in the preceding paragraph, **by a lien on all valuable property of the Debtor.**" (318 U.S. at 456, 87 L.ed. at 922)

Again, speaking of the allocation of income bonds, the Court said:

> "Some of these bonds, on the other hand, go to creditors secured by the refunding bonds. **This is because the refunding bonds have a first lien on some assets.**" (318 U.S. at 484, 87 L.ed. at 938)

Again:

> "Here it is sufficient to say that as determined by the Commission, **the Refundings had a lien superior to the Firsts on some assets** (233 Inters. Com. Red. F. 414), and the Firsts superior over the Refunding on the major portion." (318 U.S. at 488, 87 L.ed. at 940)

Since the refunding bonds were a first lien on certain assets, those bonds had an absolute priority as to **such** assets. Since the refunding bonds were a general lien on **all** of the valuable assets of the debtor, subject only to the prior lien of the Firsts, if the assets subject to the prior lien of the Firsts were sufficient to satisfy the Firsts, the value remaining, if any, constituted value under the refunding bonds. **But** whether the holders of first-mort-

gage bonds were made whole or not—whether there was any value left after applying to the first-mortgage bonds the value of all property upon which those bonds had a first lien, to the extent necessary to make the holders of the Firsts whole, or not—it is clear that the assets upon which the refunding bonds had a first lien plus residual value, if any, after exhausting the lien of the first-mortgage bonds **was not sufficient to discharge the obligations secured by the refunding bonds or to make whole the creditors who held refunding bonds as security.**

In the first place it is abundantly clear that there was nothing left over for unsecured claims and that unsecured claims were valueless (Opening Brief of The Railroad Credit Corporation on its appeal, pp. 19, 20). But, more important, the Commission found that the holders of refunding bonds did not have a lien on security sufficient to make them whole and that they would not be made whole. The Commission found (I-R 271), and this finding is quoted by the Supreme Court (318 U.S. 462, 87 L.ed. 926), that

> "it is clear that even although all the securities remaining available for distribution after satisfying the claims of the first-mortgage bondholders are allotted to the other secured creditors, **such securities will be inadequate to satisfy their claims.**"

Moreover, as we demonstrated in the Opening Brief of The Railroad Credit Corporation on its appeal, p. 16, et seq., The Railroad Credit Corporation had a second lien on the $10,750,000 refunding bonds held by Reconstruction Finance Corporation; Reconstruction Finance Corporation's claim of $3,682,869.98 exhausted this security and

other security, too; and, by consequence, these same bonds in the hands of The Railroad Credit Corporation in the principal amount of $4,000,000 could not have a value of more than $1,437,346. Since the allocation of new securities was not upon the basis of the amount of the creditor's claim, but was on the basis of the value of the security held by the creditor (Opening Brief of The Railroad Credit Corporation on its appeal, p. 18 et seq.), The Railroad Credit Corporation was not entitled to have distributed to it securities which would represent more in value than the security it held, i. e., $1,437,346. By the distribution of such new securities it could not possibly be made whole.

On the matter of accommodation collateral held by The Railroad Credit Corporation, it is true that the Plan of Reorganization itself (reading only the **Plan** and disregarding the rest of the order in which the Plan is contained) has no affirmative statement. But it is **not** true that the **order** which contains the Plan is silent on the subject of accommodation collateral. That order recites the making of the original report and order of October 10, 1938, and then recites the further consideration and the making of the supplemental report "**which report is hereby referred to and made a part hereof**" (I-R 362, 363). That supplemental report, so incorporated by reference in the order of June 21, 1939, contains the following:

> "Under the Bondholders' Committee's modified plan, * * *. All collateral pledged by others than the Debtor as security for the Debtor's note to the Finance Corporation, Credit Corporation, and James Company would be surrendered to the pledgors thereof * * *. Conclusion.—We do **not** approve that part of the foregoing provisions which states that all collateral

pledged by others than the Debtor as security for the Debtor's notes to the Finance Corporation, Credit Corporation, and James Company would be surrendered to the pledgors thereof. With this provision eliminated, we approve the foregoing provisions." (I-R 344, 345)

Appellant's Brief, p. 5, points out that questions were raised as to the status of accommodation collateral pledged by persons other than the Debtor, and says: "No provision with regard to such collateral was included in the **Plan** of Reorganization." If this statement is given a most limited and restricted construction, and so construed can be said to be correct, it is only a half truth as a statement of fact. It is incorrect as matter of law. "The Commission's order must be read against the background of the record" (*Penn. R. Co. v. U. S.,* 55 F.Supp. 473, 489,—Dist. Ct. N.J.,—3 Judge Dist. Ct.). When, as here, the Commission uses its standard form of order which refers to its report and says the "report is hereby referred to and made a part hereof," the report becomes part of the order and the order must be read in connection with the report. (*Gulf etc. Co. v. Ill. C. R. Co.,* 21 F.Supp. 282, 289, col. 1, and cases cited[10] (Dist. Ct. Tenn.), app. dis. 109 F.2d 1016 (C.C.A. 6); *American Express Co. v. So. Dak. ex rel. Caldwell,* 244 U.S. 617, 626, 61 L.ed. 1352, 1359, col. 1.)

The opinion of the Supreme Court determines the effect to be given to the action of the Commission. (See 318

10. "The order of the Commission, however, expressly refers to and makes the report of the Commission, containing its findings of fact and conclusions thereon, a part of the order. Both the report and the order were filed on May 22, 1933. The order must be read in connection with the report. (*Georgia Public Service Commission v. U. S.,* 283 U.S. 765, 75 L.ed. 1397; *Illinois Commerce Commission v. U. S.,* 292 U.S. 474, 78 L.ed. 1371; *Beaumont S. L. & W. Ry. Co. v. U. S.,* 282 U.S. 74, 75 L.ed. 221)"

U.S. 503-506, 87 L.ed. 947-949.) The Court quotes the original order that the rights of The Railroad Credit Corporation "in collateral pledged with them by parties other than the Debtor' should not be disturbed or altered". It goes on:

> "On consideration of the petitions for modification of this order, the Commission refused to direct that this collateral be 'surrendered to the pledgors thereof'."

Again, referring to accommodation collateral, pledged by others than the Debtor, the Court said:

> "This collateral, other than refunding bonds, was therefore **left** with the **pledgees** with its position unaffected by any direct action of the Commission * * *. Of course, the collateral loan to the Debtor which was not an obligation of the Debtor could not be ordered by the Plan to be cancelled. **It remained with the pledgees.** * * * The A. C. James Company unsecured claim against the Debtor for the loan of the bonds is valueless, 233 Inters. Com. Rep. (f) 452, and the Plan does not deal with any possible claim of accommodation pledgors against the pledgees of bonds which were not the property of the Debtor."

The Plan of Reorganization Did Not, as Matter of Law, Make The Railroad Credit Corporation Whole and Exonerate the Accommodation Collateral Held by It, Where Its Claim Was Not Fully Satisfied in Fact, but, to the Contrary, Such Claim Is Squarely Contradicted by the Order of the Interstate Commerce Commission itself.

The Plan of Reorganization certainly did not contain any express provision that the allocation of securities under the Plan should operate or be deemed, as matter

of law, to make The Railroad Credit Corporation whole and exonerate the accommodation collateral held by it. (Some plans have stated that the new securities were to satisfy the claims or discharge guarantors. See notes 38, 43 and 44 below.) It is not claimed that the Plan had any such express provision. To the contrary, the first step in the argument is that the Plan is silent; that "no provision with regard to collateral was included in the Plan of Reorganization" (Appellant's Brief, p. 5).

While it may be true literally that there was no provision in the "Plan", it is also literally true that there was a provision in the "Order" of the Commission touching the accommodation collateral. That order referred to and incorporated the report. The effect was a specific and express refusal of a demand that the accommodation collateral be returned. The Commission considered the matter and expressly determined that neither by direct order, nor by effect of the Plan, was The Railroad Credit Corporation to return the collateral to the Pledgors. To use the language of the Supreme Court, the Commission refused to direct that the collateral be surrendered; it was "**left** with the **pledgees**, with its position unaffected by **any** direct action of the Commission." We need not repeat what has just been gone over at some length. (See pp. 20 to 27 above.)

This without more should be enough to dispose of the appeal on the merits. In the language of the court below:

> "The Western Pacific Railroad Corporation is attempting to do what the Supreme Court said could not be done **by the Plan.**" (II-R 197)

Final Confirmation of a Plan of Reorganization Under Section 77 Does Not, by Force of the Statute, Exonerate Accommodation Collateral.

Given the two propositions (1) that The Railroad Credit Corporation was **not made whole in fact**, and its claim against the Debtor was not **in fact** satisfied, and (2) that the Plan itself does not provide that it, or distribution of new securities under it, shall operate in legal contemplation to make The Railroad Credit Corporation whole, satisfy its claim, and exonerate accommodation collateral, the question still remains whether the Plan, or its operation, discharging the **Debtor**, by force of the statute operates to discharge accommodation collateral.

The Plan itself contains **no** statement that the **claim** of the Railroad Credit Corporation, even as to the Debtor, is released, discharged or satisfied, or other words to that effect. Subdivision R provides that the capital stock of the Debtor, and the unsecured claims "shall be cancelled." It further provides that "existing mortgages on the **Debtor's** property shall be released and cancelled, and all funds on deposit with the Trustees on the Debtor's mortgages * * * and all collateral pledged under the **Debtor's** mortgages shall be surrendered **to the reorganized company** free from lien of the Debtor's mortgages" (II-R 394). If the Debtor, by reason of the confirmation and carrying out of the Plan, acquired any defense to the **claims** against it, that of The Railroad Credit Corporation included, it must be by force of the statute. If the **claims** of The Railroad Credit Corporation (as distinguished from the security held by it) is in any way affected, it is only by force

of the statute and only to the extent and in the way the statute provides.

So far as the statute is concerned, the only effect of confirmation and carrying out of the Plan of Reorganization is to give the **Debtor** (but no one else) a personal defense. These are the relevant provisions of the Bankruptcy Act:

Section 77(f) provides:

> "The **property dealt with by the Plan,** when transferred and conveyed to the Debtor or to the other corporation or corporations provided for by the Plan, or when retained by the Debtor pursuant to the Plan, shall be free and clear of all claims of the **Debtor,** its stockholders and creditors, and the **Debtor** shall be discharged from its debts and liabilities, except such as may consistently with the provisions of the Plan be reserved in the order confirming the Plan or directing such transfer and reconveyance or retention * * *"[11]

Section 77(l) provides:

> "In proceedings under this section and consistent with the provisions thereof, the jurisdiction and powers of the court, the duties of the Debtor and the rights and liabilities of creditors, and of all persons with respect to the Debtor and its property, shall be the same as if a voluntary petition for adjudication

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11. This provision is no broader than that contained in the sections dealing with bankruptcy in general. Section 1 provides: "'Discharge' shall mean the release of a bankrupt from all of his debts which are provable in bankruptcy, except such as are excepted by this act." Section 17 provides: "A discharge in bankruptcy shall release a bankrupt of all of his provable debts, whether allowed in full or in part, except such as" and the exceptions are then specified.

had been filed and a decree of adjudication had been entered on the day when the Debtor's petition was filed."

Section 16(a) provides:

"The liability of a person who is a codebtor with or guarantor or in any manner a surety for a bankrupt shall not be altered by the discharge of such bankrupt."

There were provisions like §16 in the Acts of 1800,[12] 1841[13] and 1867[14] and decisions under the earlier acts may still be looked to. (See 1 *Collier, Bankruptcy,* 14 ed. §16.01. Cf. *Zavela v. Reeves,* 227 U.S. 625, 630, 57 L.ed. 676, 678, col. 2.)

Even in the absence of such a provision as that in §16(a), accommodation collateral securing a claim against a bankrupt debtor is not released by final disposition[15] of a proceeding under the bankruptcy act because of the very limited nature of those dispositions. The only effect of final disposition of a proceeding under the bankruptcy act is to give the debtor or bankrupt a personal defense,—**personal to him,**—which **he** may set up if sued upon a claim that has been discharged; of which he can avail

12. Section 34 provided: "That no such discharge of a bankrupt shall release or discharge any person who was a partner with such bankrupt, at the time he or she became bankrupt, or who was then jointly held or bound with such bankrupt for the same debt or debts from which such bankrupt was discharged as aforesaid."

13. Section 4 provided: "That no discharge of any bankrupt under this act shall release or discharge any person who may be liable for the same debt as a partner, joint contractor, endorser, surety, or otherwise, for or with the bankrupt."

14. Section 33 provided: "* * * and no discharge granted under this act shall release, discharge, or affect any person liable for the same debt, for or with the bankrupt, either as partner, joint contractor, endorser, surety, or otherwise."

15. We say "disposition" because the same rule applies to discharges in bankruptcy, compositions under the bankruptcy act and reorganizations under the bankruptcy act.

himself **only** by setting it up affirmatively; a defense which the debtor or bankrupt waives if he fails affirmatively to plead it.

Helms v. Holmes, 129 F.2d 263, 265, 266, 141 A.L.R. 1367 (C.C.A. 4);[16]

First National Bank v. Henderson, 243 Ala. 636, 11 So.2d 366;[17]

Amer. Improvement v. Lilienthal, 43 Cal.App. 80, 184 P. 692 (hr. den.);

Winter v. Trepte, 234 Wis. 193, 290 N.W. 599;[18]

Moyer v. Dewey, 103 U.S. 301, 26 L.ed. 394;

Feltner v. Hoskins, 248 Ky. 697, 59 S.W.2d 974;[19]

Way v. Barney, 116 Minn. 285, 133 N.W. 801;[20]

Gurley v. Robertson, 178 Ala. 326, 59 So. 643;

Glenn, Surety's Right to Indemnity, 31 Yale L. Jour. 582, 584.

"The theory is that the discharge destroys the remedy, but not the indebtedness." (*Zavelo v. Reeves,* 227 U.S.

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16. Held, that a Federal Court would not enjoin execution on a default judgment obtained against a bankrupt who, by defaulting, neglected affirmatively to set up his discharge in bankruptcy; that the defense must be pleaded and is waived by failure to plead it.

17. Defense of discharge in bankruptcy is waived if not pleaded.

18. This case involved not a discharge in bankruptcy but a reorganization under §77B.

19. The court noticed that under §16 "the liability of a person who is jointly liable with the bankrupt for a debt is in no way released or impaired by reason of the discharge of the bankrupt" and then said: "The intention and purpose of the statute is to make a discharge of a bankruptcy personal to the bankrupt and not to release any other party who may in any way be liable with him."

20. Here the rule is applied to hold that liens are not released or affected by discharge in bankruptcy. "The discharge of a debtor in bankruptcy does not extinguish the debt, but relieves him from all legal obligation to pay it, leaving unimpaired all remedies for securing payment thereof out of property upon which it is a lien. *Hill v. Harding,* 130 U.S. 699, 32 L.ed. 1083; *Evans v. Stalle,* 88 Minn. 253, 92 N.W. 591; *Leitch v. Railway Co.,* 95 Minn. 35, 103 N.W. 704." This case held that discharge of a corporation did not release stockholders' liability.

625, 57 L.ed. 676, followed in *First National Bank v. Henderson, supra; First National Bank v. Pothuisje,* 217 Ind. 1, 25 N.Ed2d 436.) The discharge "is neither a payment nor an extinguishment of debts. It is simply a bar to their enforcement by legal proceedings." (*Helms v. Holmes, supra; Livesay v. First National Bank,* 57 S.W.2d 86, 91 A.L.R. 873 (Tex. Com'n of Appeals);[21] *Burtis v. Wait,* 33 Kans. 478, 6 P. 783, 785.[22] See *Glenn, Surety's Right to Indemnity,* 31 Yale L. Jour. 582, 584.)

The same rule has been applied to a composition under the bankruptcy act—there is no "payment or extinguishment of the debts" but only a bar to remedies. (*American Improvement Co. v. Lilienthal, supra* (holding that security was not affected); *In re Kornbluth,* 65 F.2d 400, 402, 403 (C.C.A. 2).)

In view of §16, there can be no doubt that final disposition of a proceeding under the bankruptcy act does not affect the creditor's rights against any person or thing other than the debtor or bankrupt himself. (See *Glenn, Surety's Right to Indemnity,* 31 Yale L. Jour. 582, 584; note 31 Col. L. Rev. 1348, 1353.) The rule has been applied in a wide variety of circumstances, and to discharges in bankruptcy, compositions and reorganizations:

Endorsers:

Myers v. International Trust Co., 273 U.S. 380, 71 L.ed. 692;[23]

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21. Here it was held that the proceeding under the bankruptcy act did not destroy an insurable interest in the debtor's life.

22. Held, that the proceeding under the bankruptcy act did not satisfy the debt and did not release a mortgage on the property of a third person given as accommodation security for the debt.

23. A composition under the bankruptcy act by a partnership did not release the individual liability of the partners as endorsers.

Winter v. Trepte, 234 Wis. 193, 290 N.W. 599;[24]

B. M. C. Durfee Trust Co. v. Steiger, 296 Mass. 136, 4 N.E.2d 1014;

Luther v. Lemons, 210 N.C. 278, 186 S.E. 369.[25]

Transferee of Mortgaged Property Who Assumed the Mortgage:

Security Savings Bank v. Scott, 3 Cal.App. 687, 86 P. 903.

Guarantor of Rent:

Central National Bank v. Mills, 62 Ohio App. 413, 24 N.E.2d 607 (cert. den. 313 U.S. 593, 85 L.ed. 1547).[26]

Maker of a Bond to Pay Railroad Tariffs:

Johnston v. Missouri Pac. R. Co., 203 Ark. 1036, 160 S.W.2d 39.

Makers of Various Forms of Bonds:

Hill v. Harding, 130 U.S. 699, 703, 32 L.ed. 1083, 1084;

Rosenthal v. Nove, 175 Mass. 559, 56 N.E. 884;

State v. Oakley, 129 Wash. 553, 225 P. 425, 428.[27]

Liability Insurer:

Miller v. Collins, 328 Mo. 313, 40 S.W.2d 62.

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24. Reorganization under Section 77B.

25. The creditor filed his claim and received and retained a bankruptcy dividend.

26. Reorganization under Section 77B. Under the plan the creditors were to take stock and the creditor in question accepted his allotment of stock.

27. A creditor filed his claim and received and retained a bankruptcy dividend.

Co-Debtors, Whether Liable as Principals or as Sureties:

Helms v. Holmes, supra;

Abendroth v. Van Dolsen, 131 U.S. 66, 33 L.ed. 57;

Vandenburgh v. Goodfellow, 19 C.2d 217, 225, 120 P.2d 20;

Feltner v. Hoskens, supra;[28]

First National Bank v. Kinslow, 2 C.A.2d 456, 459, 38 P.2d 136;[29]

Bass v. Geiger, 73 Fla. 312, 73 S. 796, cert. den. 244 U.S. 653, 61 L.ed. 1373;[30]

First National Bank v. Hoffman, 102 Kans. 465, 171 P. 13;

Buckeye etc. Bank of Protogere, 250 Mich. 252, 231 N.W. 65.[31]

Transferee of Property Transferred by the Bankrupt in Fraud of Creditors:

Moyer v. Dewey, 103 U.S. 301, 26 L.ed. 394.

And the same rule applies to the property of third persons which is provided as accommodation security for the debt of the bankrupt or debtor:

Burtis v. Wait, supra;[32]

Post v. Losey, 111 Ind. 74, 12 N.E. 121;[33]

In re American Paper Co., 255 F. 121 (D.N.J.).

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28. It was immaterial that the co-debtor was a surety only.

29. Accommodation co-maker was not released.

30. Composition under the bankruptcy act did not release accommodation co-maker of a note.

31. In this case and in *First National Bank v. Hoffman,* it was immaterial that the creditor had received part payment by a bankruptcy dividend.

32. Here a wife mortgaged her separate property. She did not execute the note.

33. Here the person providing the security became a co-maker of the principal obligation.

Cf.:

Chickasaw Hotel Co. v. C. M. Barker Const. Co., 135 Tenn. 305, 186 S.W. 115;

First National Bank v. Pothuisje, supra;

Kolakowski v. Cyman, 285 Mich 585, 281 N.W. 332.

The creditor's rights against third persons are not prejudiced because he does not file a claim in the bankruptcy proceeding. "Nor is the creditor prejudiced by filing of his claim or by accepting a dividend on liquidation in bankruptcy of the debtor's estate or in a composition under the former composition provisions of the bankruptcy act." (1 *Collier, Bankruptcy,* 14th Ed. §16.05.) The rule was applied in the following cases, elsewhere cited in this brief: *First National Bank v. Hoffman, supra; Buckeye, etc. Bank v. Protogere, supra; State v. Oakley, supra; Luther v. Lemons, supra; Kolakowski v. Cyman, supra; Gurley v. Robertson, supra.*

Appellant suggests that The Railroad Credit Corporation, in some way, not clear to us, estopped itself by participating in the reorganization proceedings; that it waived its rights; that by consent it changed the surety's position. The suggestion is made without supporting authority. The suggestion is not a new one. It has been made and met before "where there are compositions under the bankruptcy act and where there were reorganizations". The composition cases seem stronger than the reorganization cases because the composition partakes more of the nature of a contract and proceeding outside the bankruptcy proceeding itself than does the reorganization.

The leading composition case is *Myers v. International Trust Co.,* 273 U.S. 380, 71 L.ed. 692. The holding was

that a composition by a partnership did not relieve the partners of individual liabilities by reason of individual endorsements. The Court said that it was settled by its decisions

> "that a composition is 'a settlement of the bankrupt with his creditors'—in a measure superseding and outside of the bankruptcy proceedings,—which originates in a voluntary offer by the bankrupt, and results, in the main, from voluntary acceptance by his creditors; that the respective rights of the bankrupt and the creditors are fixed by the terms of the offer; and that upon the confirmation of the composition they get what they 'bargain for' and no more."

It was held, nevertheless, that the composition with the partnership did not extend to the individual partners and did not release them as endorsers.

> "The necessary result is that the confirmation of the composition merely discharged the partnership debts, and did not discharge the separate debts of the partners to their individual creditors, who were offered and received no consideration for such release."

In *Guild v. Butler,* 122 Mass. 498, 23 Am.Rep. 378 (noticing the English cases); *Barker v. Ackers, infra,* note 40, p. 40; *McClintic-Marshall Co. v. New Bedford,* note 35, p. 38 below; and *In re Kornbluth,* 65 F.2d 400, 402 (C.C.A. 2), the court noticed the distinction between a settlement between debtor and creditor, which was wholly voluntary, where the release of the debtor was solely by act of the parties, and a composition under the bankruptcy act where the discharge of the debtor was worked by operation of

law. (See, also, *Glenn, Surety's Right to Indemnity,* 31 Yale L. Jour. 582, 586.) In the *Kornbluth Case* the court said:

> "Judicial analysis of the nature of a composition in bankruptcy has proceeded along the lines indicated, and has almost uniformly given a composition in bankruptcy the effect of a discharge in bankruptcy, rather than that of a composition outside of bankruptcy * * *. Likewise, an ordinary composition of a principal's debt, resting as it does in contract, is generally held to release the surety, whereas a discharge in bankruptcy does not. Accordingly, composition in bankruptcy has been universally held not to discharge the surety."
> (Citing cases)

See, further, as to the effect of a composition under the bankruptcy statute, the following:

Bass v. Geiger, supra;

Barker v. Ackers, 29 C.A.2d 174, 175, 84 P.2d 264 (hr. den.);

Dunham Bros. Co. v. Colp, 125 Me. 211, 132 A. 388;

Martin Furniture Co. v. Massey, 135 Tenn. 338, 186 S.W. 451;[34]

McClintic-Marshall Co. v. New Bedford, 239 Mass. 216, 131 N.E. 444;[35]

Pacific Bank v. Michaelson, 216 App. Div. 120, 214 N.Y.S. 715;

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34. The creditor voted for the plan and had accepted the shares of stock distributable to him under it.

35. The creditor accepted the composition offer. It was held that the composition barred remedies, but the debt was not paid or extinguished. "A composition under the bankruptcy act is entirely different from a voluntary composition deed. A discharge in bankruptcy is not by the agreement of the parties, but by operation of law, and is binding on the parties, not by reason of their consent, but by force of the statute."

Easton Furniture Mfg. Co. v. Cominez, 146 App. Div. 436, 131 N.Y.S. 157;[36]

A. Klipstein Co. v. Lipschitz, 130 Misc. 291, 223 N.Y.S. 822.[37]

The same rules apply and the same results are reached in the cases considering the effect of corporate reorganizations under the bankruptcy act. We are not aware of any cases under Section 77. But there have been a number of decisions considering the effect of a reorganization under Section 77B. Section 77B had a provision like Section 77(l) providing that "all other provisions of this act, except such as are inconsistent with the provisions of this section, shall apply to proceedings instituted under this section". The uniform holding has been that §16 is applicable to reorganizations.

In re Diversey Bldg. Corp., 86 F.2d 456 (C.C.A. 7—cert. den. 300 U.S. 662, 81 L.ed. 870);[38]

In re Nine North Church Street, 82 F.2d 186 (C.C.A. 2);

In re Prudence Co., 55 F.Supp. 464 (E.D. N.Y.);[39]

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36. The creditor agreed to the composition in this case and in the *Pacific Bank Case.*

37. The rule is stated although not necessary to the decision because the guarantor consented.

38. One Becklenberg had guaranteed corporate bonds. The plan of reorganization provided for the issuance of new bonds and for release of Becklenberg's guarantee provided that he would guarantee the new bonds. Held, that the court could not enjoin a creditor who had not assented to the plan from suing on the old guarantee. The court had no power to release the guarantor. Here the plan affirmatively and in terms purported to release the guarantor. It is only fair to notice that in *Stoll v. Gottlieb,* 305 U.S. 165, 171, note 8, 83 L.ed. 104, 108, note 8, rehr. den. 305 U.S. 675, 83 L.ed. 437, the court left this matter open: "We express no opinion as to whether the Bankruptcy Court did or did not have jurisdiction of the subject matter." The court notices the *Diversey Bldg. Corp. Case, In re Nine North Church Street, supra,* and the *Willsea Case, supra.*

This precise question we do not reach in the case at bar because the Plan did not attempt to release the accommodation collateral. To the contrary, a suggestion that the accommodation collateral should be returned to the original pledgors was expressly rejected. (See pp. 20 to 27 above.)

39. The plan expressly reserved rights under a guaranty. The creditor accepted new securities under the plan.

Barker v. Ackers, 29 C.A.2d 162, 173, 84 P.2d 264 (hr. den.);[40]

Mazur v. Stein, 314 Ill.App. 529, 41 N.E.2d 979;[41]

B. M. C. Durfee Trust Co. v. Steiger, 296 Mass. 136, 4 N.E.2d 1014;[42]

Union Trust Co. v. Willsea, 275 N.Y. 164, 9 N.E.2d 820, 112 A.L.R. 1175;[43]

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40. The question here was whether stockholders' liability was released by a plan of reorganization. The note holders' protective committee agreed to the plan, and from this it was argued that they had lost their right to proceed on the stockholders' liability. The court said: "The very purpose of the stockholders' liability and the only value in it is the protection it affords when the debtor corporation itself is unable to met its obligations. It must be noted also that there is a difference between a common-law composition and a composition in bankruptcy. In the former the creditors voluntary release the principal debtor and therefore release codebtors, while in the case of a bankruptcy composition the discharge is by operation of law and not by act of the creditor who assents to the composition. Upon the institution, as in the instant case, of proceedings for corporate reorganization under Section 77B of the Bankruptcy Act, the creditor is forced to cooperate in the proceedings for a composition or a corporate reorganization, for whether or not he appears or consents to a composition or corporate reorganization, the bankrupt or debtor, as the case may be, may be discharged. The creditor is without choice but to attempt to obtain or assent to the composition or plan of reorganization which he deems the most favorable."

41. Section 16 was held to apply under Section 77B.

42. The creditor accepted the plan reserving his rights against an endorser. Under the plan the creditors were to get cash and stock. The creditor in question accepted this "in full satisfaction of its claim against the maker" of the note. If as matter of law accepting the plan and accepting the cash and new securities distributable under it would release an endorser it would seem clear that the attempted reservation of rights, being inconsistent, would be of no effect. However, such reservation of rights being in harmony of the rule of law, no harm was done. The case was not turned on the attempted reservation of rights.

43. A plan of reorganization was carried out. The creditor in question was active in the proceedings and accepted the stock distributable under the plan. The order expressly stated that the stock should be payment. Held, that a guarantor was not released. Composition cases are applied by analogy. The reorganization proceeding did not affect the independent guarantee agreement. "The proceeding under Section 77B is subject to all other applicable provisions of the Bankruptcy Act * * *. Section 16 (11 USCA §34) thereof expressly provides that the liability of one who was a guarantor or surety for a bankrupt shall not be altered by the discharge of such bankrupt. By analogy, the cases are applicable which hold that a composition in bankruptcy between a principal debtor and holders of instruments issued by it, does not discharge the liability of endorsers, sureties, or guarantors upon such instruments, even though they participate in the composition proceeding as creditors of the principal debtor and accept dividends on the instrument from the maker. Respondent, in accepting the new stock, did not accept it as payment or partial payment of its claim. There is no allegation in the answer as to the value of the stock. For all that appears, it may not have any value."

Seixas v. Hegeman, 158 Misc. 560, 285 N.Y.S. 838, aff'd 246 App. Div. 813, 287 N.Y.Supp. 331;

Central National City Bank v. Mills, 62 Ohio App. 413, 24 N.E.2d 607, cert. den. 313 U.S. 593, 85 L.ed. 1547;[44]

Winter v. Trepte, 234 Wis. 193, 290 N.W. 599;[45]

Finletter, Principles of Corporate Reorganization in Bankruptcy (1937), p. 378 et seq.;

Finletter, The Law of Bankruptcy Reorganization (1939), p. 409 et seq.

It would be extraordinary to have the release of the Debtor operate to release accommodation collateral. The giving of accommodation collateral presupposes that the creditor is not willing to make an advance unless it is secured. It further presupposes that the debtor has no ade-

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44. A creditor took stock of a debtor under a plan of reorganization. The court's order provided that the stock should be payment. Held, that a guarantee of rent was not released. The argument which is made in the case at bar was rejected. The court noticed Section 16a and held that under it the guarantee was not released. The court said: "If that debtor has a perfectly solvent guarantor or surety, we see no reason why the debtor's discharge in bankruptcy should deprive the creditors of the benefit of the security he has taken, possibly for the very reason that the principal debtor was of doubtful responsibility."

45. In a reorganization proceeding, stock was distributed to the holder of bonds. The order purported not to effect payment of the bonds or to discharge the liability of the guarantor. The doctrine of release of a surety by release of the principal was held not to apply because release of the principal was by operation of law. "Neither this plan nor the act of the owners of the bonds nor their predecessors thereto extinguishes the original debt or discharges the guarantors from their liability under the guarantee." As a basis for its holding the court said: "The reasons underlying this rule are that the entire matter is subject to the control of the bankruptcy court and intended for the relief of insolvent debtors, who are the only ones to be discharged, and that whatever is done to the debt is done by operation of law and does not constitute a release by the creditor. The debt itself is not extinguished. The discharge of the bankrupt forms a personal defense to him against further litigation on the debt declared upon in the bankruptcy proceeding. Being but a personal defense, it is not available to anyone else. Starting with the admitted fact that in bankruptcy the guarantor or surety is not discharged by the release of the bankrupt, it follows that in the absence of payment no release of the guarantors can be claimed. This is because the creditor does as he is required to do under the provisions of law. Whatever results were produced by the reorganization proceedings were accomplished by operation of law and not by the voluntary acts of the creditor."

quate security to give and for this reason it must be furnished by the third person. The transaction on its face discloses to the giver of the accommodation collateral, and he contemplates, that the Debtor may be unable to meet the claims against it, that its property will not satisfy those claims and that, in a proceeding under the Bankruptcy Act, the creditor will not be fully satisfied. The very purpose of giving the accommodation collateral is to meet this situation,—to permit the creditor to resort to the accommodation collateral in the event of such difficulties. The discharge of the Debtor in a proceeding under the Bankruptcy Act, without satisfaction of the creditor in fact, is the very reason for accommodation collateral. It would be most extraordinary to have it exonerated by the very eventuality against which the pledgor of the accommodation collateral designed it to give protection. (See *Central National Bank v. Mills,* quoted in note 44 above; *Barker v. Ackers,* quoted in note 40 above, and *In re Nine North Church Street,* 82 F.2d 186, 188, col. 2 (C.C.A. 2).)

A Consideration of Various Suggestions Made by Appellant Will Demonstrate That They Are Wide of the Mark.

Appellant suggests that because the Railroad Credit Corporation participated in the reorganization proceedings it is estopped to claim that it was not made whole and, by its conduct, having changed the position of the principal debtor, the accommodation collateral was released. There is no attempt to show that any conduct of The Railroad Credit Corporation in fact prejudiced the position of the accommodation collateral or of the appellant. Certainly The Railroad Credit Corporation, to retain its accommo-

dation collateral, was not required arbitrarily to object to, and refuse to consent to, a plan which the Commission, the District Court, and the Supreme Court of the United States have found to be reasonable and proper, or to urge fanciful last minute changes. Such conduct would be hostile to the whole spirit and purpose of §77. To the contrary, our duty was to collaborate in working out a plan which would give us as much as possible of the debtor's property so that to that extent, at least, the accommodation collateral might be exonerated. No such issue was raised below. If this is the basis of appellant's claim, as distinguished from a construction of the order of the Commission, it is a confession that the court below had no jurisdiction of the independent action. (See p. 51 below.) But the real answer is that if the debtor was released, the release was not by voluntary act of the parties, but was by operation of law. (See pp. 29-41 above.)

In support of the position that though The Railroad Credit Corporation was not made whole in fact, it was made whole in legal contemplation by the Plan, appellant urges that the Plan provided that the securities distributable to The Railroad Credit Corporation should be reduced to the extent of anything received from the Debtor's distributive share under the Marshaling and Distributing Plan, 1931, reducing the common stock at $62 per share. It is believed that the construction of the Plan relied upon is incorrect. This question is before the Court on the appeal of The Railroad Credit Corporation in 10,962. (See the Opening Brief of The Railroad Credit Corporation on its appeal.) But whether we are correct or incorrect, the consideration suggested has no bearing.

In dealing with the Debtor's share under the Marshaling and Distributing Plan, 1931, the Plan was dealing with **property of the Debtor.** The problem there was one of allocation of new securities among creditors, having regard for the security held by each and to be surrendered by them. It was only a matter of fixing a proper relation between the creditors. The appropriateness of the determination depended only upon its relative correctness. Even if, by the distribution of new securities, the various creditors were not made whole, it might still remain that if a creditor had and retained property which was that of the Debtor the securities otherwise distributable to that creditor should be reduced. Proper adjustment must be made among all creditors to preserve their relative priorities among themselves, whether they are made whole, in fact or in law, or not. In such an adjustment, the manner in which the Debtor's property is dealt with (whether or not deduction of new securities to be issued is to be made because of debtor's property retained by a creditor), without more, has no tendency to show that a creditor has been made whole, in law or in fact, and has no bearing upon the status of accommodation collateral.

An argument is attempted to be bottomed on the proposition that the holders of first mortgage bonds were made whole. The suggestion presents neither head nor tail. It is suggested that the holders of Firsts must be made whole before any part of the Debtor's property can pass to the holders of junior securities. This wholly overlooks the facts that the so-called junior securities, general and refunding bonds, were themselves a **first** lien on a substan-

tial part of the Debtor's property.[46] (See pp. 21 to 23 above.) Appellant's brief is not even clear as to whether it considers the Firsts were or were not made whole. At places it is stated that the Firsts were made whole[47] and then, in contradiction, it is said that they were not.[48] But the important consideration is that it is immaterial whether holders of Firsts were or were not made whole. If holders of first mortgage bonds were senior creditors or had a senior lien on the bulk of the Debtor's property, it might well be that they were made whole, and still junior creditors would not be made whole, in law or in fact. If

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46. In Appellant's Brief, p. 22, it is said the first mortgage was a first lien on all the Debtor's properties valued for purposes of reorganization at $97,863,562 except money and securities valued by the Commission at $1,897,965 subject to a paramount lien under the refunding mortgage. The Commission made no finding of value on the Debtor's property. The very reason this court reversed the order of the District Court confirming the Plan was that no such findings were made and it was the opinion of this court that such findings should be made. What the Commission found was that the Debtor's property had a value (regard being had for the income) which would warrant the issuance of certain securities,—bonds, income bonds and preferred stock having par value and no par common stock. This is a very different thing from finding the value of a Debtor's property. The figure $1,879,965 was not found as the value of the property subject to the first lien of the general mortgage bonds. It is a figure reached by adding together the principal amount of the income bonds and the par of the preferred stock allotted to the holders of general mortgage bonds.

It should be noticed that two of the figures in note 40 at p. 53 of the Opening Brief of The Railroad Credit Corporation on its appeal are incorrect. The figure $1,221.89 should be $1,217.89 and, by consequence, the figure $27,313.61 should be $27,309.61.

47. It is said that 89,253 shares were not required to make the Firsts whole and were therefore allotted to other security holders (Brief, p. 23), that "it is clear that the holders of first mortgage bonds are made whole by what was given them in new securities" (p. 30), and then, in immediate sequence, it said: "it must not be inferred, however, that the first mortgage bondholders are made whole when given the equivalent of 100% of the principal and interest upon their bonds." (p. 31) Again it is said that the Commission and the Court determined that the Firsts would be made whole, plus compensation for their surrender of seniority (p. 43).

48. At p. 31 it is said it is not to be inferred that the Firsts were made whole (see note 47) and at p. 37 it is said: "* * * but the making whole of the first mortgage bondholders was a mere legal fiction which may not be extended to a junior creditor so as to prevent the junior creditor from enriching himself further at the expense of an accommodation surety", whatever this may mean. If the making whole of the Firsts is a mere legal fiction and if this legal fiction is not to be extended to a junior creditor, it follows that not even by legal fiction was the junior creditor made whole.

junior creditors got only what was left after the Firsts were taken care of, what was left might well be wholly insufficient to satisfy their claims. This is the finding of the Commission. (See p. 19 et seq. above.) This was the basis of its allocation of new securities in proportion to the security held rather than in proportion to the amount of claims.

It is said that under the Plan, and as matter of law, The Railroad Credit Corporation was required to take new no-par common stock at $62 per share; that since at this figure, the stock allotted to it, with other securities, computes out at substantially the amount of its claim, it must be considered that it was made whole. The legal presumption is directly to the contrary. The legal presumption is that where a **creditor** having a secured claim, carrying a fixed rate of interest, was required to take in exchange common stock, changing its creditor's position for a mere equity ownership, even if at a face equivalent, it was not made whole; that a creditor is not made whole when it is required to surrender a senior form of security for no more than the equivalent in principal amount of an inferior grade of security. (Cf. *Institutional Investors v. Chicago, M. St. P. & P.,* 318 U.S. 523, 569, 87 L.ed. 960, 1009.)

But the Plan does not indicate that $62 was the value of the common stock to The Railroad Credit Corporation for any purpose other than a formal statement of the relative priorities of the various creditors. There is no mystery in the way in which the figure of $62 was reached. In its first report the Commission assumed that the first mortgage bonds had an overall priority position. Accord-

ingly, the two classes of senior securities (other than bonds for new cash) were all assigned to the first mortgage bondholders. The holders of general and refunding mortgage bonds received only the junior securities, common stock. (See pp. 19, 20 above.) Upon reconsideration, it was found that the general and refunding mortgage bonds were a first lien on substantial property. Accordingly, some income bonds and preferred stock were allotted to the holders of the general mortgage bonds. This required an adjustment of the common stock. (See pp. 21 to 23 above.) In making the new allotment, allotment was made to The Railroad Credit Corporation and the James Company on precisely the same basis, i. e., the proportion of general and refunding mortgage bonds held by each. In the case of The Railroad Credit Corporation, when this allotment was compared with the total amount of its claim, an arbitrary factor of $62 per share developed (Opening Brief of The Railroad Credit Corporation on its appeal, p. 52 et seq.). The same process would develop a figure of $154 per share for the James Company. It is conceded that the James Company was not made whole, in law or in fact (Appellant's Brief, p. 42).

There is another interesting comparison. In its original report, the Interstate Commerce Commission allotted all of the senior securities, income bonds and preferred stock, to the senior creditors and in addition allotted to them 154,241 shares of the no-par common stock, leaving only 159,462 shares of no-par common stock allotted to the junior creditors who held general and refunding mortgage bonds. (See pp. 19, 20 above.) When the Commission filed its supplemental report, it concluded that the general and

refunding mortgage bonds were a first and senior lien on certain assets and, therefore, entitled, to some extent, to receive senior securities. It found that the general and refunding mortgage bonds held a first lien upon property of sufficient value to warrant the allocation to the holders of general and refunding mortgage bonds, and of the first lien income bonds of the principal amount of $732,010 and preferred stock of a par value of $1,147,955. The total of this principal amount at par value is $1,879,965. This amount of senior securities it allotted to the holders of general and refunding mortgage bonds on account of the first lien of said bonds. It then undertook to compensate by reducing the common to go to holders of Refundings and increase the common to the Firsts. It, therefore, allotted to the holders of the general and refunding mortgage bonds, not the 159,642 shares of no-par common originally allotted to them, but only 88,847 shares, and it allotted the other 70,615 shares of the no-par common stock, plus the additional common provided for, to the holders of the Firsts. A comparison of the 70,615 shares of no-par common taken from holders of the Refundings with the $1,879,965 principal and par of senior securities given them would indicate that the no-par common had a value of $26.6 plus per share.

What is the conclusion? Simply that there is no way to read the Plan of Reorganization, in the light of the full record, particularly the original report of the Commission, and to arrive at a conclusion that the Commission made any attempt to assign any value to the no-par common stock except for the purpose of stating an arbitrary factor which would do nothing more than reflect the relative gen-

eral and over-all priority position of the Firsts. (See Opening Brief of The Railroad Credit Corporation on its appeal, p. 52, et seq.)

Appellant agrees that the common stock cannot be taken at one value for one purpose and at another value for a different purpose all in the same plan (Appellant's Brief, p. 27). Yet this is what appellant attempts. In stating that the holders of the first mortgage bonds took the common at an assigned value of $57, it is said that the holders of the Firsts were thereby made whole.[49] This assumes a value of $57 per share. (See Appellant's Brief, pp. 30, 32.) Yet, almost in the same breath, it is said that $62 is the real value (Appellant's Brief, pp. 31, 32). The brief blithely ignores what the assigned value would be in the case of the James Company and wholly overlooks the fact that a value of $50 per share was assigned for purpose of conversion of bonds. (See Opening Brief of The Railroad Credit Corporation on its appeal, top of p. 54.)

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49. It cannot be assumed that at the same time the real value of the common stock was $62, either in fact or in law under the Plan. If such an assumption is made, the holders of Firsts were more than made whole.

The suggestion that the real value is $62 and that the holders of Firsts were allowed a differential of $5 to compensate them for giving up a senior position will not hold water. A comparison of the original plan with the final plan (see pp. 17 to 23 above) will disclose that under the final plan the holders of general mortgage bonds received some of the new income bonds and preferred stock, not because of any assumed differential of $5 per share allowed on the common stock, but because, on reconsideration, it was found that the lien of the general and refunding bonds was a first lien on certain assets of the Debtor. Because of this it was necessary to make a new allocation and allot to the holders of general mortgage bonds some of the income bonds and preferred stock. This necessitated (for the purpose of maintaining the respective priorities of the parties, and recognition of the general overall priority of the Firsts) an allotment of some of the common to the Firsts. It happened that when this was done and the securities allotted were compared with the amounts of the various claims there was a differential of $5 in the arbitrary values assigned to the common as between holders of Firsts and The Railroad Credit Corporation. But as to the James Company (which was in exactly the same position as The Railroad Credit Corporation, except that it did not hold as much security per dollar of claim) the differential was $97.

But, even if, for purposes of the Plan, we took the common at $62 per share, and this operated between us and the Debtor to release the Debtor, **this was only between us and the Debtor.** (See pp. 29-41 above.)

The action of the District Court cannot possibly disturb the Plan or affect the allocations made. Only The Railroad Credit Corporation and The Western Pacific Railroad Corporation are interested in or can be affected by the matters involved on the latter's appeals.

Conclusion as to the Merits.

Perhaps we have been guilty of unduly magnifying appellant's position. We believe that the whole matter can be stated very shortly. **Appellant does not contend that The Railroad Credit Corporation was made whole in fact.** Its only argument is that The Railroad Credit Corporation was made whole as matter of law. The only foundation claimed for this is the Plan itself. It is said that the Plan made The Railroad Credit Corporation whole and exonerated the accommodation collateral. **But this is precisely what the Supreme Court said the Plan did not do.** (See pp. 26 to 28 above.) The District Court was correct when it said that appellant, in attempting so to make use of the **Plan**, was attempting to attribute to the Plan the very thing which the Supreme Court said the Plan did not do.

IV.

THE DISTRICT COURT PROPERLY ENTERTAINED THE PETITION FOR CONSTRUCTION OF THE PLAN IN THE REORGANIZATION PROCEEDING AND PROPERLY DISMISSED APPELLANT'S INDEPENDENT ACTION.

The necessary interrelation between the construction to be given the Plan of Reorganization and appellant's independent action, and the absolute dependence of that independent action upon a question of the meaning and effect of the Plan is sharply silhouetted by the complaint in the independent action. The complaint alleges that both plaintiff and defendant are Delaware Corporations (Par. I, III-R 2). There is no diversity of citizenship. Jurisdiction to entertain the action depended solely on the presence of a Federal question (U. S. Const., Art. III, §2). The pleader realized this. He attempted to state a Federal question. It is alleged that the action is one "arising under the Constitution and laws of the United States of America"; "that the cause of action herein asserted arises under and by reason of the orders and decrees of this Court and the Supreme Court of the United States approving the plan of reorganization of the Debtor * * * and necessarily involves an interpretation of said orders and decrees" (Pars. II, IX, III-R 2, 9). This is the only attempt to present a Federal question. The remaining allegations of the complaint demonstrate that this is the only Federal question which could be asserted. Without this question there was no jurisdiction. So the independent action necessarily depended and turned upon the question of, and the answer to be given as to, the meaning and effect of the Plan, the very matter presented in the reorganization proceeding itself.

This is true not only as matter of jurisdiction to entertain the independent action, but is true of the merits of the question presented. The only claim made in the independent action was that when properly construed the **Plan**, as matter of law, exonerated the accommodation collateral. If the question of the meaning of the Plan were determined adversely to the plaintiff, no other question remained. On the merits, then, plaintiff's right to the relief sought in the independent action depended upon the answer to the question presented by the petition to the Reorganization Committee.

It is not to be doubted that the District Court has jurisdiction to entertain the petition of the Reorganization Committee and to determine the meaning and effect of the Plan, even as to The Western Pacific Railroad Corporation.

The Western Pacific Railroad Corporation asserts that it is not a party to the Plan.[50] It seems to proceed upon the assumption that, because it receives nothing under the Plan, it is not a party to it. But it cannot be questioned that it was a party to the reorganization proceedings. (See p. 5 above.) And it is a party to the Plan even though it received no benefit under the Plan. The Plan expressly dealt with it. The Court had jurisdiction to deal with it. (See note 5, p. 5 above.) It did not lose jurisdiction simply because the Plan afforded The Western Pacific Railroad Corporation no affirmative relief.

Nor can it be doubted that the District Court had jurisdiction, prior to the distribution of the new securities

50. This presents another of the many inconsistencies of appellant's brief. If appellant is not a party to the Plan, upon what legal theory can it claim that any provision of the Plan is binding in fixing its relations with The Railroad Credit Corporation?

under the Plan, prior to the return of its property to the Debtor, and prior to the general consummation of the Plan and discharge of the Trustee, to make such orders as might be necessary to carry out the Plan, construing the Plan where necessary. It had the broad powers of a court of equity (*Continental Illinois Nat. Bk. v. Chicago, R. I. & P. Ry. Co.*, 294 U.S. 648, 675, 79 L.ed. 1110, 1127. Cf. *In re Utilities etc. Corp.*, 90 F.2d 798 (C.C.A. 7)) to do what was necessary to fully dispose of the matters before it and administer upon the estate of the Debtor. This is precisely what is contemplated by Section 77(f). (Cf. *National Lock Co. v. Hogland*, 101 F.2d 576, 583 et seq. (C.C.A. 7); *In re 4145 Broadway Hotel Co.*, 131 F.2d 120 (C.C.A. 7—cert. den. 318 U.S. 776, 87 L.ed. 1137); *Clinton Trust Co. v. John H. Elliott Leather Co.*, 132 F.2d 299 (C.C.A. 2); *Shores v. Hendy Realization Co.*, 133 F.2d 738 (C.C.A. 9).) In particular, that section provides that on confirmation of the plan the Debtor or any other corporation organized for the purpose shall have power to carry out the plan and put it into effect,—"shall put into effect and carry out the plan and the orders of the judge relative thereto, under and subject to the supervision and control of the judge." Under §1(20) " 'Judge' shall mean a judge of a court of bankruptcy" (not an arbitrator). The probability that further action of the court after confirmation of the plan would be needed to carry the plan into execution was too obvious to escape the attention of Congress.

No express reservation of jurisdiction by the court was necessary. But even if it were, we have it. It is Paragraph V of the Plan, which the Court made its own, when it

adopted the Commission's findings and Plan and confirmed the Plan. This was one purpose of Paragraph V. The other purpose was to remove any doubt as to whether, in construing the Plan, or making additional and necessary supplemental orders, there was a requirement of resubmission to the Commission. If the Plan in the first instance required the approval of the Commission, someone might argue that any order construing it, or supplementing it, or providing for some necessary step in carrying it into execution, required the approval of the Commission. Paragraph V anticipated such a possibility and removed doubt.

If we are correct as to the jurisdiction of the District Court, and if it properly entertained the petition of the Reorganization Committee for construction of the Plan, passed on that petition, and construed the Plan, there was nothing left to be determined in the independent action and the independent action was properly dismissed. It can make little difference whether this dismissal is put upon the ground that the matter was necessarily involved in the reorganization proceedings and, properly, should be determined there, or upon the ground that the only matter of substance having been determined, the defendant in the independent action was entitled to summary judgment.

But if we are wrong that determination of the question in the reorganization proceeding necessarily disposed of the independent action, and if the issue tendered by the independent action was one to be determined only in that action, it still remains that the action of the trial court in dismissing the independent action was correct. The motion to dismiss the independent action was not submitted solely upon the complaint and the motion to dismiss. **Upon the**

motion the Court had before it the full record. (See pp. 6 to 10 above.) Upon the full showing made and submitted to the Court plaintiff was not entitled to the relief sought. The only question tendered was the meaning and effect of the Plan. In view of the full record, the Plan could have but one meaning,—it did not exonerate accommodation collateral. There was nothing else in the independent action and it was properly dismissed on the merits disclosed by the showing *de hors* the complaint.

V.

THE JUDGE OF THE DISTRICT COURT ACTED AS AN ARBITRATOR AND THIS COURT HAS ~~NO~~ JURISDICTION OF THE APPEAL.

It is suggested that this Court has no jurisdiction of an appeal from the order in the reorganization proceeding. If so, appellant's appeal should be dismissed. The point is implicit in the assertion made that the court below was acting only as an arbitrator in the reorganization proceeding when it construed the plan of reorganization. The suggestion is made without supporting reference to the record or to authority. No such supporting reference can be found. The court below was not acting as an abritrator. It was acting as a court of bankruptcy under Section 77(f). To say more would be to repeat what has just been said. (See pp. 51 to 54 above.)

CONCLUSION

The District Court performing the functions contemplated by Bankruptcy Act §77(f), for the purpose of carrying out the confirmed plan of reorganization, and supervising the action of the parties in carrying it out, when called upon to do so in the reorganization proceedings, properly entertained a proceeding for construction of the Plan. Its responsive order, insofar as The Western Pacific Railroad Corporation questions it, was correct. It properly held that the Plan did not operate to exonerate the accommodation collateral held by The Railroad Credit Corporation. This necessarily disposed of appellant's independent action. But, if not, it still remains that the judgment in that action should be affirmed. The motion was not determined solely upon the face of the complaint and the motion. The court had before it the full record and all the facts. Its judgment is correct. Appellant asks a determination of the real merits. It got such a determination. It is in no position to complain.

It is respectfully submitted that so much of the order in the reorganization proceedings as is drawn in question on the appeal of The Western Pacific Railroad Corporation in No. 10,962 should be affirmed and that the judgment appealed from in No. 10,966 should be affirmed.

Dated at San Francisco, May 17, 1945.

Arthur B. Dunne,
Attorney for Respondent The Railroad Credit Corporation.

Edward G. Buckland,
William J. Kane,
Of Counsel.